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District Director E:E:PSPB
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Assistant Chief Counsel (Income Tax & Accounting)

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This is in response to your request for technical assistance in regard to the application of section 62(c) of the Internal Revenue Code and Rev. Proc. 89-67, 1989-2 C.B. 795, to the reimbursement policies of the [redacted] Subsequent to the receipt of your request for assistance the Service published Rev. Proc. 90-60, 1990-52 I.R.B. 29, superseding Rev. Proc. 89-67. Accordingly, we will reference only to the latest revenue procedure.

The [redacted] (the "State") has raised three questions concerning the effect of section 62(c) of the Code and the regulations promulgated thereunder to its method of reimbursing state employees for travel expenses. The questions are as follows:

1. The State believes its method of reimbursement of employee travel expenses constitutes a "flat rate" that represents one amount, as opposed to an allowance that reimburses per diem expenses by separating the component elements of lodging, meal, and incidental expenses. Is the State reimbursement allowance properly classified as a "flat rate" versus one that itemizes the component elements? If the State's position is correct, how would Rev. Proc. 90-60 be applied.

2. Would a reimbursement allowance meet the requirements of section 1.62-2 of the Income Tax Regulations for purposes of the taxation of and reporting and withholding on payments with respect to employee travel expenses, if the State reimbursed its employees for per diem expenses on the basis of actual expenses for M&IE coupled with the Federal lodging expense rate? This would be a reversal of the provisions of Rev. Proc. 90-38, 1990-28 I.R.B. 13, which was superseded by Rev. Proc. 90-60.

3. Can an employee or employer select a method based solely on whether there will be a requirement for reporting and withholding? For example, an employee stays in a high cost area and is reimbursed for actual lodging costs of $52, and a per diem for meals of $37. Under the "meals only per diem method", the

employee would be subject to $3 of income reported, assuming the Federal M&IE rate for the locality of travel is $34. Under the "High/Low Method", there would be no reporting of income.

Section 3.01 of Rev. Proc. 90-60 provides that the term "per diem allowance" means a payment under a reimbursement or other expense allowance arrangement that meets the requirements specified in section 1.62-2(c)(1) of the regulations and that is (1) paid with respect to ordinary and necessary business expenses incurred, or which the payor reasonably anticipates will be incurred, by an employee for lodging, meal, and/or incidental expenses for travel away from home in connection with the performance of services as an employee of the employer, (2) reasonably calculated not to exceed the amount of the expenses or the anticipated expenses, and (3) paid at the applicable Federal per diem rate, a flat rate or stated schedule, or in accordance with any other Service-specified rate or schedule.

The term "Federal per diem rate", is defined in section 3.02 of Rev. Proc. 90-60, as being composed of the sum of the Federal lodging expense rate and the Federal meal and incidental expense (M&IE) rate for the locality of travel.

Section 3.03 of Rev. Proc. 90-60 provides, in part, that an allowance is paid at a flat rate or stated schedule if it is provided on a uniform and objective basis with respect to the expenses described in section 3.01. Such allowance may be paid with respect to the number of days away from home in connection with the performance of services as an employee or on any other basis that is consistently applied and in accordance with the reasonable business practice. Thus, for example, an hourly payment to cover meal and incidental expenses paid to a pilot or flight attendant who is traveling away from home in connection with the performance of services as an employee is an allowance paid at a flat rate or stated schedule. Likewise, a payment based on the number of miles traveled (e.g., cents per mile) to cover meal and incidental expenses paid to an over-the-road truck driver who is traveling away from home in connection with the performance of services as an employee is an allowance paid at a flat rate or stated schedule.

In discussing the application of the 80-percent limitation on meal expenses provided for in section 274(n) of the Code, section 6.05 of Rev. Proc. 90-60 provides, in part, that when a per diem allowance is paid for lodging, meal, and incidental expenses, the payor must treat an amount equal to the Federal M&IE rate for the locality of travel for each calendar day the employee is away from home as an expense for food and beverages.

When a per diem allowance for lodging, meal and incidental expenses for a full day of travel is paid at a rate that is less than the Federal per diem rate for the locality of travel, the payor may treat an amount equal to 40 percent of such per diem allowance for a full day of travel as the Federal M&IE rate for the locality of travel.

Accordingly, in regard to the first question we do not view the State's reimbursement allowance as being in the nature of a "flat or stated schedule", as it is not based on the number of miles traveled, hours worked or pieces produced. Rather, it is based on a per diem expense allowance and, as such, is the sum of the components of lodging, meals, and incidental expenses.

Section 1.274-5T(g) of the temporary regulations, in part, grants the Commissioner the authority to prescribe rules relating to reimbursement arrangements or per diem allowances for ordinary and necessary expenses paid or incurred while traveling away from home. The Commissioner may prescribe rules under which such arrangements or allowances will be regarded (1) as equivalent to substantiation, by adequate records or other sufficient evidence, of the amount of such travel expenses and (2) as satisfying the requirements of an adequate accounting to the employer of the amount of such travel expenses for purposes of section 1.274-5T(f).

Section 1.274-5T(j) of the temporary regulations provides that the Commissioner may establish a method under which a taxpayer may elect to use a specified amount or amounts for meals while traveling away from home in lieu of substantiating the actual cost of meals. The taxpayer would not be relieved of substantiating the actual cost of other travel expenses as well as the time, place, and business purpose of the travel.

There is no provision in either the regulations or the rules prescribed pursuant to the authority granted to the Commissioner whereby a reimbursement arrangement as described in the second question would be deemed to meet the substantiation requirements of section 274(d) of the Code. Accordingly, an arrangement under which an employee is reimbursed at actual expenses for M&IE costs and at the Federal expense rate for lodging would not be considered an accountable plan as that term is used in section 1.62-2 of the regulations. However, we should point out that section 6.02 of Rev. Proc. 90-60 provides that a receipt for lodging expenses is not required in order to apply the Federal per diem rate or the Federal lodging expense rate for the locality of travel.

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In regard to the third question raised by the State, section 5.05 of Rev. Proc. 90-60, provides that a payor that uses the high-low substantiation method with respect to an employee must use that method for all amounts paid to that employee for travel away from home within CONUS during the calendar year. However, with respect to that employee, the payor may still reimburse actual expenses or use the meals only per diem method for any travel away from home. As noted in section 4.02 a per diem allowance is treated as paid only for meals and incidental expenses if (1) the payor pays the employee for actual expenses for lodging, (2) the payor provides the lodging in kind, (3) the payor pays the actual expenses for lodging directly to the provider of the lodging, (4) the payor does not have a reasonable belief that lodging expenses were or will be incurred by the employee. Accordingly, with regard to the third question, only the payor may select the method of reimbursement, and then, only within the parameters provided in the above cited provision.

As indicated in section (39)8313 of the Chief Counsel Directives Manual, this reply is advisory only and does not represent an expression of the views of the Internal Revenue Service as to the application of law, regulations, and precedents to the facts of a specific case. This reply is not to be furnished or cited to taxpayers or representatives and is not to serve as the basis for closing a case. This matter will not be recommended for publication as a revenue ruling.

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